

**Before the
Federal Communications Commission
Washington, D.C. 20554**

Federal-State Joint Board on Universal Service)	
Proposed Fourth Quarter 2004)	CC Docket No. 96-45
Universal Service Contribution Factor)	
)	
AT&T Petition for Declaratory Ruling Regarding)	WC Docket No. 03-133
Enhanced Prepaid Card Services)	

**EXPEDITED PETITION TO REDUCE OR ADJUST THE
PROPOSED FOURTH QUARTER CONTRIBUTION FACTOR**

WilTel Communications, LLC (“WilTel”) submits this Expedited Petition to Reduce or Adjust the proposed universal service contribution factor for the fourth quarter of 2004. *See* Public Notice, DA 04-2976, CC Docket No. 96-45 (rel. Sept. 16, 2004)(“*Public Notice*”). The Commission should not accept the Wireline Competition Bureau’s proposed 8.9 percent factor without further action to meet the requirements of Sections 254(a)(4) and (d). Expedited action is required to prevent the Bureau’s unlawful proposed factor from being “deemed approved” by the Commission on September 30, 2004.

INTRODUCTION

At least \$150 million in contributions are immediately at stake in this proceeding, affecting the bills of virtually every telecommunications customer in the country. And this figure appears to be the tip of the iceberg. The legitimacy of the proposed fourth quarter contribution factor -- and the associated burden on customers and carriers -- is more broadly in

question because the Commission is not clearly stating and enforcing its universal service rules. The discriminatory application of USF charges implicit in the current proposal is harming competition in the industry, and is ultimately detrimental to the Fund itself.

The Commission must take immediate action to eliminate such discrimination in the recovery of USF contribution, beginning with the fourth quarter factor under review here. Sections 254(a)(4) and (d) of the Telecommunications Act expressly provide that contributions to the universal service fund must be made on “an equitable and nondiscriminatory” basis. 47 U.S.C. § 254(a)(4) and (d). This statutory mandate is a critical underpinning of the Telecommunications Act of 1996. Congress included universal service provisions in the 1996 Act to ensure that support funds – previously collected through implicit subsidies imposed on particular industry segments – would now be collected in a competitively neutral manner even as competition expanded throughout the telecommunications industry. By contrast, discrimination in the collection of USF contribution unfairly burdens some telecommunications customers at the expense of others. Discrimination distorts telecommunications markets and competition among providers. Discrimination undercuts the credibility of the universal service program itself, encouraging non-compliance and threatening the program’s revenue base and public support.

The Commission has 14 days under its Rules to modify the Bureau’s proposed contribution factor. 47 C.F. R. § 54.709(a)(3). In this case, the Bureau’s proposal presents serious issues that require action now to reduce or adjust the proposed factor to more closely meet the requirements of Section 254(a)(4) and (d). At a minimum, the Commission should immediately complete action on AT&T’s long-pending *Petition for Declaratory Ruling Regarding Enhanced Prepaid Card Services*. (See WC Docket No. 03-133)(“*AT&T Petition*”). In addition, the Commission should direct additional actions over the next 60 days so that the

first quarter 2005 factor (scheduled to be proposed on or before December 17) is in fact “equitable and non-discriminatory” as required by the Act. As discussed below, the 8.9 percent factor proposed in the *Public Notice* does not meet that statutory requirement, and expedited Commission action is required now, before this unlawful factor otherwise takes effect.

DISCUSSION

A. The Need for a Non-Discriminatory Contribution Factor

The universal service contribution factor is so important because it is so large, and so disproportionate to the razor thin margins available in the telecommunications industry. The proposed 8.9 percent “tax” on revenues is highly distortionary and discriminatory when it is not recovered equally from all competitors. There is at least one fully-briefed case before the Commission where a carrier (AT&T) has been an explicit “non-contributor” to the Fund, having withheld tens of millions of dollars that its competitors continue to pay. Moreover, WilTel believes that the rest of a large “non-contributor” iceberg lies just below the surface.

Non-contribution by some providers has dual adverse and discriminatory impacts on paying companies. First, a non-contributor would have an 8.9 percent cost advantage over competitors. Second, as the result of contribution avoidance, the Fund no longer collects a fee on every assessable dollar of service sold by certain companies. The Fund, in turn, responds by raising (or not lowering) the percentage contribution of those firms that do continue to pay, opening the window of discrimination even wider.

The final result of this process is clear: non-contributors beat contributors in the marketplace solely by virtue of the discriminatory application of USF payments, and the Fund loses its sources of revenue. Customers face a higher than necessary “tax rate” on their

telecommunications costs. However, the Commission has the necessary tools to avert such an outcome.

WilTel has repeatedly emphasized the need for the Commission to address and enforce its universal service rules -- and its related interstate access rules -- so that all companies are treated in an equitable and non-discriminatory manner. In an efficient market success or failure depend on the relative service quality and efficiency of a provider, and not on that provider's propensity to game the regulatory process to avoid access and universal service payments. Unfortunately, the key driver of financial success in the voice market today rests not in efficiency and innovation, but in tolerance for "regulatory risk." Some companies "self-interpret" the Commission's rules to mean that their particular services are exempt from USF and/or access. This action gives them a large competitive advantage, at the risk of retroactive liability if the Commission later rejects their legal position. Other providers abstain from taking such regulatory risk, but in the meantime they pay disproportionate universal service fees and are unable to meet low market prices set by the legally aggressive "self-interpreters." 1/

The proposed fourth quarter contribution factor here is infected by this *de facto* discrimination. The revenue assumptions reflect the self-reporting of the service providers, right or wrong. The practical result is that the proposed factor is too high to the extent that regulatory risk takers are not paying their fair share of universal service as required by the rules. And, to the extent that more conservative companies have been unnecessarily paying into the fund for services that do not require it, the factor may even be too low.

1/ WilTel has discussed this dilemma in more detail elsewhere. *See, e.g.,* Letter to Chairman Powell from Blaine Gilles, Senior Vice President, WilTel Communications, LLC, WC Docket No. 03-133 (Aug. 16, 2004).

B. Actions Required Before a Final Fourth Quarter Contribution Factor Can Be Set

1. *Completion of the Long-Pending AT&T Enhanced Prepaid Card Docket*

In connection with establishing the fourth quarter contribution factor, the FCC must finally complete action on AT&T's *Petition for Declaratory Ruling Regarding Enhanced Prepaid Card Services*. By AT&T's own admission, over \$150 million in potential universal service revenues are at stake in that proceeding. ^{2/} This figure does not include revenues being withheld or tacitly non-reported by other carriers taking AT&T's regulatory approach with respect to "enhanced" services. The *AT&T Petition* docket has been open for over a year and the record is more than complete. The Commission can and should issue its order before September 30, and apply the results in calculating the fourth quarter contribution factor.

By definition that decision would make the final USF factor more compliant with Section 254 than the rate proposed in the *Public Notice*. The impact on the Fund, consumers, and the industry would be substantial. If the Commission concludes that AT&T is required to pay universal service contributions for its so-called enhanced prepaid card service, then it immediately should be required to send USAC the \$150 million the company admits that it has been withholding based on its legal argument. This single "true-up" payment would reduce the

^{2/} AT&T has reported this \$150 million potential obligation to USAC in its most recent SEC Form 10-Q. The actual amount due is now higher based on the additional fees AT&T has withheld since June 30, the end of the reporting period covered by that filing. This is in addition to approximately \$290 million in access charges that AT&T states that it also has withheld on the same legal theories. See AT&T Corporation, SEC Form 10-Q, *Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, for the Quarterly Period Ended June 30, 2004*, at 13 (filed Aug. 4, 2004) ("it should be noted that the current [information service] classification of AT&T's enhanced prepaid card service has generated approximately \$290 million in access savings since the third quarter of 2002, and approximately \$150 million in USF contribution savings since the beginning of 1999").

USF contribution factor by over 11%, from 8.9% to 7.9%. (See Attachment A.) ^{3/} That reduction would have a direct impact on every telecom customer in the country, and all of their service providers. Collectively, customers would be spared making up the \$150 million that AT&T has held back. Proportional savings would flow through to every other customer, including small businesses, residential customers, the federal government, military families, and users of prepaid cards offered by other vendors who have been contributing to USF.

Alternatively, if the Commission decides that AT&T is not required to contribute to universal service in these circumstances, the same rule necessarily applies to other providers of similar telecommunications services. The proposed contribution factor would need to be reassessed to take into account refunds due to other providers, and reductions in contributing revenues going forward. WilTel understands that the Commission may not be in a position to include such adjustments in this quarter's contribution factor. However, the Commission at least should instruct the USAC and the Wireline Competition Bureau to evaluate these revenue matters in developing the factor to be used in the first quarter of 2005.

2. *Immediate Enforcement of the USF Rules So That Future Quarterly Contribution Factors Comply With Section 254*

Again, the legal deficiencies in the fourth quarter factor go beyond the \$150 million withheld by AT&T for its prepaid cards. This figure does not include revenues from other

^{3/} The contribution factor actually could go even lower due to (i) AT&T's payment of additional USF amounts withheld since June 30 and not included in its report as of that date; (ii) additional interest and penalties due from AT&T; (iii) inclusion of future AT&T card revenues in USAC revenue projections; and (iv) better compliance from other companies that may not be reporting revenue and paying USF contribution in similar circumstances. However, the Commission could direct USAC and the Bureau to incorporate these matters in its consideration of the first quarter 2005 contribution factor.

carriers who continue to withhold USF contributions based on their own aggressive regulatory approaches with respect to so-called “enhanced” services.

The lawfulness and legitimacy of universal service depend on the Commission enforcing current law clearly, fairly, and strongly. Thus, however the Commission decides the *AT&T Petition*, it should also direct USAC, the Wireline Competition Bureau, and the Enforcement Bureau to take other actions so that the first quarter 2005 contribution factor fully complies with the non-discrimination requirements of Section 254. As discussed above, the Commission has a statutory mandate to ensure that all parties are paying their fair share of universal service under the existing Commission rules, reporting assessable revenue accurately and making required payments. Commission inaction has encouraged an environment in which companies are incentivized to call their services “enhanced” or otherwise mischaracterize the nature of traffic and not pay USF on the associated revenues. The Commission has been slow to address these claims, and has not always penalized companies for their “aggressive” legal positions by requiring retroactive payments. The Commission’s inaction - combined with the competitive significance of USF and access avoidance - has driven even naturally conservative firms to look for novel legal justifications to avoid payments and remain competitive with their more aggressive peers.

The Commission has recognized this problem, terming it “regulatory arbitrage.” ^{4/} For example, the Commission should investigate whether long-distance carriers and CLECs are

^{4/} See *Developing a Unified Intercarrier Compensation Regime*, Notice of Proposed Rulemaking 16 FCC Rcd 9610, ¶ 12 (2001) (“*Intercarrier Notice*”) (“[A]ny discrepancy in regulatory treatment between similar types of traffic or similar categories of parties is likely to create opportunities for regulatory arbitrage. That is, parties will revise or rearrange their transactions to exploit a more advantageous regulatory treatment, even though such actions, in the absence of regulation, would be viewed as costly or inefficient.”); see generally *id.* at ¶¶ 11-18.

avoiding access charges and USF by mischaracterizing non-Internet long-distance calls as local. These calls may be originated with an ILEC customer and passed off to the CLEC as a “local” call, but then routed by the CLEC across exchanges (using an affiliated or nonaffiliated long distance carrier) to terminate over local interconnection trunks in a distant LATA. As a result, the CLEC/long distance carrier may reduce the amount of assessable interstate revenue reported to USAC by mischaracterizing the calls as local. 5/

Strong and timely enforcement of the Commission’s existing rules is crucial to satisfy Section 254’s requirement that contributions be collected on an “equitable and non-discriminatory basis.” If the Commission recommit itself to that process now, the result should be a lower contribution factor in the future, imposed more fairly on customers, with less distortion of market forces. This process should begin immediately, so that it can be fully reflected in the first quarter 2005 contribution factor. 6/

C. **Given the Impact of Commission Policies on the USF Contribution Level, the Commission should Rededicate Itself to Addressing Pending USF-Impacting IP-Enabled Service Issues in a Manner Consistent with Section 254**

The Commission should keep these factors in mind as it considers when and how to address the novel and mostly-unanswered questions presented in the IP-Enabled Services

5/ In addition, the ILECs charge the CLEC only the much lower local termination rate, rather than the significantly higher interstate access rate. The CLEC and long distance carrier may share the benefit of the savings in universal service and intercarrier compensation.

6/ To the extent that these actions increase the revenues coming into the USAC, they should ameliorate any increase to the factor that might otherwise occur in 2005 as a result of action in the AT&T Enhanced Card docket. Thus, if the fourth quarter factor is reduced because AT&T is required to pay the \$150 million it has held back to date, the factor may stay near that level due to better enforcement generally. Conversely, if the Commission finds that AT&T’s actions have been lawful, better enforcement may protect the contribution factor from going even higher when other providers stop paying for their similar “enhanced” services, and seek refunds for past USF payments.

rulemaking (including an analysis of how Section 254 obligations apply to IP-Enabled Services) and related proceedings. *See Notice of Proposed Rulemaking, IP Enabled Services*, WC Docket 04-36, FCC 04-28, at ¶¶ 63-66 (rel. Mar. 10, 2004). ^{7/} The Commission's answers to these complicated and novel questions can have a direct impact on the size of the contribution factor in future years, and the degree to which avoidance of USF will drive service design and competition. As the telecommunications industry evolves, the Commission must ensure that contribution requirements are clear (so they cannot be "gamed") and nondiscriminatory in order to meet Section 254's legal requirements. Moreover, the Commission must act quickly; continued delay in addressing these issues will result in additional quarters in which the contribution factors do not address the industry's changing face.

CONCLUSION

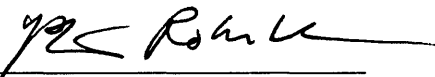
WilTel respectfully requests that the Commission not accept the Wireline Competition Bureau's proposed fourth quarter 2004 contribution factor of 8.9 % without taking further expedited action to meet the requirements of Section 254(a)(4) and (d). In particular, the

^{7/} This docket incorporates universal service issues raised in other pending petitions. *See, e.g.,* Level 3 Communications LLC's Petition for Forbearance Under 47 U.S.C. § 160(c) and Section 1.53 of the Commission's Rules from Enforcement of Section 251(g), Rule 51.701(b)(1) and Rule 69.5(b), WC Docket No. 03-266; Petition of Vonage Holdings Corporation for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission, WC Docket No. 03-211; Petition of SBC Communications Inc. For a Declaratory Ruling Regarding IP Platform Services, WC Docket No. 04-36.

Commission should immediately complete action on the long-pending *AT&T Petition* regarding its Enhanced Prepaid Card and otherwise enforce its contribution and reporting requirements so that the fourth quarter factor can be modified to a more accurate level. The Commission should also take immediate action to clarify and enforce its rules so that the first quarter 2005 factor, and those after that, meet Section 254's mandate of "equity and non-discrimination."

Respectfully submitted,

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September 22, 2004

ATTACHMENT A

Potential Impact on the Fourth Quarter Contribution Factor of a Decision on AT&T's Petition For Declaratory Ruling Regarding Enhanced Prepaid Card Services, WC Docket No. 03-133

Assumption: FCC denies AT&T's Petition and USAC receives the \$150 million in contribution revenue that AT&T states that it has withheld as of June 30, 2004 pending Commission action. (Note: This does not include any additional revenue withheld by AT&T since June 30, any penalties or interest, or any potential payments from other providers who may be withholding contribution while waiting for FCC action.)

Net impact: Fourth Quarter 2004 Factor is reduced from the proposed 8.9% to a final 7.9%


	Sept. 16, 2004 Public Notice Proposal	AT&T True-Up Payment	Final Calculation Reflecting AT&T Payment
USAC Projections of Industry Revenues	\$ 18.095414 billion		\$ 18.095414 billion
USF Program Collection Requirement	\$ 1.457259 billion	\$150 million	\$ 1.307259 billion
Adjusted Quarterly Contribution Base	\$ 16.471773 billion		\$ 16.620273
Unadjusted Contribution Factor	0.088470		.078654482
Final Percent Contribution Factor	8.9 % (proposed)		7.9% (final)
Unadjusted Circularity Factor	0.80532		0.72242
Final Circularity Factor	0.086007 (proposed)		0.076301 (final)

Alternative Assumption

If the Commission concludes that USAC was not entitled to receive USF contributions on AT&T's revenues for its prepaid cards, other providers will be entitled to refunds for similar revenues, and projections of future industry revenues contributing to universal service will need to be reduced. Any such adjustments and true-ups would be accommodated in the contribution factor for the first quarter of 2005.

CERTIFICATE OF SERVICE

I, Cecelia Burnett, do hereby certify that on this 22nd day of September, 2004, copies of the foregoing "Expedited Petition to Reduce or Adjust the Proposed Fourth Quarter Contribution Factor of WiTel Communications, LLC" were served by hand or by e-mail to the following:


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